CFA Institute

ADVOCACY UPDATE

GLOBAL ADVOCACY NEWS AND UPDATE

MAY 2019

IN THIS ISSUE

FOR COMMENTS OR QUESTIONS, PLEASE CONTACT

Kurt Schacht, CFA,
Managing Director
of Advocacy
advocacy@cfainstitute.org

With news breaking around the world affecting our industry—including the much-anticipated SEC vote on Regulation Best Interest and issues surrounding Brexit and EU and UK leadership—we provide you with highlights, reactions, and what the news means to our investment community. After years of working alongside other investor advocates to make changes to protect investors, curb inappropriate and conflicted advice, and end the culture of taking advantage of less-savvy individuals, we were disappointed with the SEC's June 5 decision. In this report, we identify areas where they fell short. In addition, we go beyond the headlines to provide an update on Brexit and explain where the investment industry stands. As always, we highlight new reports, important updates and activities, and media coverage our work receives. We welcome comments and questions—and wish you a happy start to summer. —**Kurt Schacht, CFA, Managing Director of Advocacy**

INVESTOR PROTECTION

REGULATION BEST INTEREST: OPPORTUNITY MISSED

Final Regulation Best Interest (Reg BI) package falls short: The US Securities and Exchange Commission (SEC) voted 3–1 to adopt a package of rules that falls far short of what its name promises. The much-anticipated, 1,200 pages of Reg BI rules has pointedly failed to create a new era of brighter, better investor protection. Instead, investors will largely remain in the dark about the conflicts, compensation methods, and standards of care that brokers will apply when giving personalized advice to retail clients. Paul Smith, president and CEO of CFA Institute, said in a recent article that the package sets "the investor protection clock back to 2008."

Our positions on Reg BI troublesome areas:

- **Fiduciary duty:** Most troubling among the new rules is the reinterpretation of investment advisers' fiduciary duty requirements. Rather than "seek to avoid" conflicts of interest, they now only must get clients consent after providing full and fair disclosure of material conflicts of interest. Rather than eliminate *and* disclose conflicts, going forward, they will have to either eliminate *or* disclose them. More of our viewpoints can be found in one of several August 2018 comment letters.
- **Incidental advice:** The SEC also took a step in the wrong direction in its interpretation of what constitutes brokers' incidental advice. Rather than narrowing its guidance to what most would see as "incidental," the SEC expanded the definition to essentially permit all broker advice so long as it is done "in connection with" the broker's primary business of effecting securities transactions. Frequency and consequence are irrelevant in what is deemed incidental. (continued on next page)

INVESTOR PROTECTION

REGULATION BEST INTEREST: OPPORTUNITY MISSED

Our positions on Reg BI troublesome areas (continued):

- **Lack of definition:** The SEC also failed to define "best interest," as so many commenters, including CFA Institute, requested (as seen in our August 2018 letter). By not defining best interest as equivalent to fiduciary in its scope, brokers will have no criteria or restrictions to claim, legally, that they are working in the clients' best interest. Nowhere does the rule state or even suggest that brokers must put investors' interests first.
- **Titles:** As evident in our January 2018 letter to the SEC, the new rules on titles were not in line with our views. Rather than restricting the use of the "adviser" title to provide distinction between brokers, who are subject to a lower standard of care, and investment advisers subject to a fiduciary duty, the SEC allows brokers to wiggle out of the title strictures and claim they are advisers. The rule is presumptive and puts the onus on enforcement and interpretation.

As has been our continuing drum-beat at CFA Institute on the importance of investor protection and transparency around broker/sales practices, our disappoint was declared in a recent article in *The Hill*, "The once-in-generation opportunity to aid consumers and financial market integrity has eluded us once again."

Moving forward: There are several initiatives underway to test the parameters and process around Reg BI, including the likelihood of several states considering whether a state-based Uniform Fiduciary Duty for personal investment advice could be possible. Meanwhile, consumer groups are considering a campaign to encourage retail investors to ask their financial service provider to put their customer's interest first and avoid conflicts or move their accounts to a more investor-first service provider. It seems the challenges to Reg BI are only just beginning.

MARKET TRANSPARENCY & FAIRNESS

COMING SOON: SIGNIFICANT CHANGES TO AUDIT REPORTS

New requirements: The US investment community needs to be prepared for the significant changes to audit reports coming over the next several months. Critical audit matters (CAMs) will now be included in audit reports, beginning with US public companies with fiscal years ending 30 June 2019. CAMs are defined as "any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that relates to accounts or disclosures that are material to the financial statements and involved especially challenging, subjective, or complex auditor judgment." For most calendar year companies, the change will not be effective until those related to 31 December 2019 financial statements. The Procter & Gamble Company, with a 30 June 2019 year-end, will be one of the first companies to report CAMs.

Our position: CFA Institute has advocated for this change to include CAMs in audit report requirements over the past decade. We believe it improves the relevance and transparency of audits by reducing information and expectation gaps, and ultimately, it will strengthen investors' confidence and trust in audited financial statements. We will be monitoring disclosures and sharing feedback with the PCAOB as they do post-implementation reviews over the next year. Please send your comments on the new disclosures to financialreporting@cfainstitute.org.

NEW US GOVERNMENT CONFIRMATIONS

Allison Lee Confirmed as SEC Commissioner

On 20 June, the US Senate confirmed Allison Lee as SEC Commissioner, bringing the five-member commission back to full strength. Ms. Lee fills the seat left vacant by former Commissioner Kara Stein, who left in January 2019. Ms. Lee has held several roles at the SEC in the past decade, including in the Division of Enforcement and as counsel to Commissioner Stein. Prior to joining the SEC, Lee was a litigation partner at the Sherman & Howard law firm and served as a special assistant United States attorney.

Heath Tarbert Confirmed as CFTC Chair

The US Senate confirmed Heath Tarbert as the new chair of the Commodity Futures Trading Commission (CFTC) on 8 June. The CFTC is an independent agency of the US government that regulates futures and option markets. Dr. Tarbert currently serves as the Acting Under Secretary for International Affairs for the US Treasury Department. His previous government experience includes Special Counsel to the Senate Banking Committee, and Associate Counsel to President George W. Bush.

ADVOCACY IN ACTION

MEDIA ATTENTION

GreenBiz (17 June) highlighted key takeaways from a recent ESG policy statement from CFA Institute.

L'Agefi (FRA) (13 June), Sviatoslav Rosov, CFA, Director of Capital Markets Policy at CFA Institute, dispelled the myths surrounding artificial intelligence.

InvestmentNews (10 June) quoted Jim Allen, CFA, Head of Capital Markets Policy at CFA Institute, on SEC's Reg BI needing better title structures.

The Hill (8 June), Kurt Schacht, CFA, Managing Director of Advocacy at CFA Institute, penned an article criticizing the passing of Reg BI.

ESGClarity (UK) (7 June) reported on CFA Institute Survey showing ESG oversight lacking in APAC.

InvestmentNews (6 June) cited Jim Allen, Head of Capital Markets Policy at CFA Institute, about Reg BI leaving investors in the advice wilderness.

Forbes (5 June) and *Pensions & Investments* (5 June) quoted Paul Smith, CEO of CFA Institute on Reg BI setting "the investor protection clock back to 2008."

Markets Media (3 June) quoted CFA Institute Director of Capital Market Policy Matt Orsagh on the lack of ESG in fixed income.

Financial Times (2 June) reported the SEC is expected to approve its BI regulation despite concerns from CFA Institute on misleading investors.

Hong Kong Economic Journal (31 May), Mary Leung, CFA, Head of Advocacy, APAC, at CFA Institute, wrote about investor protection reform.

Bloomberg (21 May), *Yahoo! Finance* (21 May), *Financial Times* (16 May), and *Pensions & Investments* (13 May) provided coverage of the CFA Institute survey showing a research quality decline under MiFID II.

Business Ethics (20 May), Matt Orsagh, Director of Capital Markets Policy at CFA Institute, wrote about ESG integration in fixed income.

MEDIA ATTENTION (continued)

BloombergTax (17 May) quoted Sandy Peters, CFA, Head of Financial Reporting at CFA Institute, on the new lease accounting changes to take effect.

NASDAQ (17 May), Kurt Schacht, CFA, Managing Director of Advocacy at CFA Institute, wrote about the Customer Relationship Summary (under the SEC's proposed Regulation Best Interest).

GLOBAL ACTIVITIES AND EVENTS

Federation of European Securities Exchanges Convention, Dublin (6 June): Josina Kamerling, head of regulatory outreach, EMEA, at CFA Institute, moderated the panel discussion, "A Sustainable Capital Markets Union in a Digital World" on the role of sustainable finance and financial technology in the development of capital markets in the European Union.

***Accounting Today* Podcast** (6 June): In *The Impact of Lease Accounting* podcast, Sandy Peters, CFA, Head of Financial Reporting Policy at CFA Institute, talked about some of the most important points for investors and accountants to consider under the new standard on leases.

Institute of Chartered Accountants of England and Wales Webinar (23 May): Exclusive webinar on the impact of IFRS 16, the lease standard, and its interaction with evolving business models and potential challenges for users.

Podcasts (22 May): A new series of podcasts, *A Guide to EU Financial Politics and Policy Development*, delivered by Josina Kamerling, Head of Regulatory Outreach, EMEA, at CFA Institute, are featured on *Market Integrity Insights* blog and iTunes. In the first three podcasts, Ms. Kamerling took stock of the regulatory measures introduced in the EU financial services sector over the course of the last five-year legislative period (2014–2019) and analyzed future policy priorities for the European Commission as well as possible political scenarios after the European elections.

PROFESSIONAL PRACTICE

BREXIT AND CROSS-BORDER INVESTMENT ISSUES

Brexit in flux: The consequential Brexit decision has been playing out in the headlines since the votes were cast in 2016. After EU leadership extended the deadline to leave to 31 October 2019, questions remain as to what this will mean for the financial services industry.

Changes in EU and UK leadership: Within the EU parliament, a series of game-changing decisions will have to be made in the next five-year period, including the following: revising the Economic and Monetary Union (EMU); completing the Banking Union; linking the Banking Union to Capital Market Union (CMU); and addressing politically sensitive national interest issues such as taxes. There are also key president positions in EU institutions open for renewal, which may affect ongoing stability. UK leadership is also in flux, as Theresa May stepped down as prime minister in early June. Each potential replacement has issued stances on Brexit, and until the party picks its new leader, a process that could run until late July, Brexit's future remains uncertain.

Cross-border issues: Brexit and its outcome represent several potential problems for the UK asset management industry, including restriction on investment management delegation; loss of passport for marketing and cross-border distribution (e.g., surrounding the Markets in Financial Instruments Directive (MiFID) and Alternative Investment Fund Managers Directive (AIFMD)); and restrictions on access to a qualified labor market.

Solutions in transition: In February 2019, a comprehensive multilateral Memorandum of Understanding (MoU) was signed by European Securities and Markets Authority (ESMA) and Financial Conduct Authority (FCA), the UK's regulator, to facilitate the exchange of information between regulators, which at least temporarily resolves the problem of investment management delegation. The ESMA MoU, however, does not resolve the problem of marketing and distribution. This could create a rift between large firms and smaller ones with fewer resources to establish bases in several jurisdictions. The EU Commission indicated its commitment to continuity through its Contingence Action Plan in December 2018 for central counterparties (CCPs) established in the UK, but this is also only temporary.

UK–Dutch regulation: Another key development on the Brexit front has been the agreement brokered between the Dutch securities supervisor, Authority for the Financial Markets (AFM), and the UK FCA in early June 2019 to cooperate closely on supervision in the period leading to and following Brexit. Many UK firms have elected to set up subsidiaries in the Netherlands to cater to all eventualities. This local initiative could generate confusion with the centralized approach preferred by ESMA. A long-term worry concerns potential pressures in the UK and EU lower regulatory standards as a result of Brexit for competitiveness reasons.

MARKET TRANSPARENCY & FAIRNESS

NEW REPORT IN OUR ONGOING ESG EFFORTS

New report: CFA Institute and the Principles for Responsible Investment (PRI) released the latest report in its series on environmental, social, and governance (ESG) integration best practices, *ESG Integration in Asia Pacific: Markets, Practices, and Data*. Focusing on eight markets in Asia-Pacific region, the report helps investors understand how they can better integrate ESG factors into their investment analysis and processes by looking at current practices, trends, drivers, and barriers as well as its overall impact on capital markets and investments.

Our ESG policy: This series is part of our ongoing, important focus on ESG that has included dozens of workshops around the world, a global survey of investment professionals, case studies, interviews, and data analysis over the past several years. CFA Institute believes that it is the duty of CFA® charterholders to factor all material information, including key ESG elements, into investment analysis. We support full disclosure and improved sustainability reporting and standardization of key ESG factors across industry sectors. CFA Institute is strongly focused on developing ESG-focused curricula and educational tools for our members and candidates. Find our full ESG policy statement and ESG content and materials on the CFA Institute website.